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DIVISION OF FINANCIAL MANAGEMENT **OCTOBER 2008 VOLUME XXXI NO. 4**

Nostalgia is by definition romantic, but the good old days were not always that good. Just ask anyone who remembers disco, k-cars, and leisure suits. As bad as these things were, they were not the worst things to come out of the late 1970s and early 1980s. A bigger calamity was runaway inflation. Nearly three decades later energy prices are soaring once again, raising fears they would ignite an inflation wildfire.

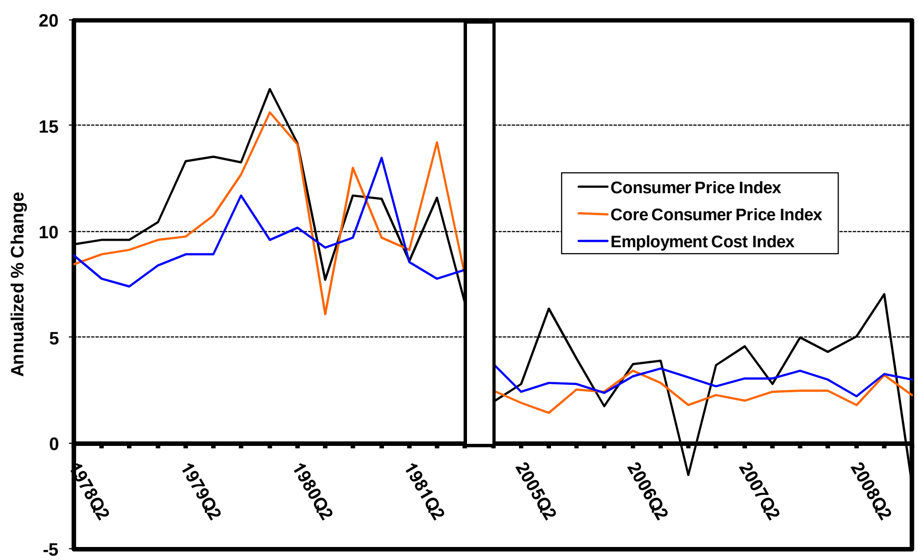
To understand why inflation will not approach historic levels, we need to first take a trip down memory lane. From the start of 1978 to the end of 1979, the refiners' average weighted price for imported crude oil nearly doubled from $14.50 per barrel to $27.00. While on the surface this seems cheap, it is important to remember a dollar went further in those days. Adjusted for July 2008 dollars, the $27.00 per barrel becomes $78.21 per barrel. The inflation-adjusted acquisition price of imported oil continued to rise and its average monthly price peaked in January 1981 at around $98.00—a record that would stand until March 2008. Not surprisingly, the real price of gasoline peaked at $3.52 per gallon two months later. Overall inflation, as measured by the Consumer Price Index for All Urban Consumers (CPI), climbed by over 10% in all but three quarters from the start of 1979 to the end of 1981.

Fast forward about three decades, and it seems we are experiencing an unpleasant bout of déjà vu. The price of oil soared to an all-time high of $147 per barrel in July 2008. The average gasoline price rose just above $4.00 per gallon in June and July of this year—another record. So far, the current situation and previous one are frighteningly similar. But there is a major difference between these two episodes. Unlike thirty years ago, overall inflation has been relatively tame, averaging about 3.5% from 2005 to 2008.

Given the similar energy price pressures, why did the CPI jump nearly 50% from the start of 1978 to the end of 1981, but rise just over 13% from 2005 to 2008? To understand this we must remember that energy prices are not the only factor driving consumer prices. This can be seen by stripping out the volatile food and energy components from the CPI. What is left is called the core CPI. The historical data show that even absent food and energy prices, the core CPI grew at double-digit rates three decades ago. By definition food and energy prices could not have contributed to the surge in the core CPI. So what was fueling core inflation?

A major driver of core inflation is labor costs because it is such a big part of the price of consumer goods and services. From 1978 to 1981, labor costs (including benefits) grew over 39%. On the other hand, they advanced by less than 12% from 2005 to 2008, despite relatively tight labor markets. This absence of labor market cost pressure helped keep the lid on both the core and overall CPI. As a result, while some parts of history have repeated themselves, inflation has not returned in a big way. Thankfully, neither have disco, k-cars, and leisure suits.

Inflation: Then and Now



Source: U.S. Department of Labor

Idaho General Fund Update

As of September 30, 2008

	$ Millions		
Revenue Source	FY 2009 Executive Estimate[3]	DFM Predicted to Date	Actual Accrued to Date
Individual Income Tax	1,334.7	275.8	276.0
Corporate Income Tax	150.2	33.5	38.9
Sales Tax	1,134.0	304.4	301.5
Product Taxes[1]	29.7	8.7	8.7
Miscellaneous	117.7	30.2	29.8
TOTAL GENERAL FUND[2]	**2,766.3**	**652.5**	**655.0**

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of August 2008

Overall General Fund revenue collections were better than expected in September, coming in $2.0 million above the amount predicted for the month. On a year-to-date basis General Fund revenue is $2.5 million (0.4%) ahead of expectations. The bulk of September's strength was from individual and corporate income taxes that were a combined $5.8 million ahead of expectations, but this was partially offset by a big drop in sales tax receipts relative to expectations for the month.

September is the first month this fiscal year that individual income tax revenue exceeded expectations for the month, coming in $4.2 million above the predicted amount. This category now stands at $0.2 million ahead on a fiscal year-to-date basis. That's the good news. The bad news is the strength is coming from filing collections, which are ahead of expectations by $7.4 million, but relate to 2007 income tax liabilities. Withholding collections, a more contemporaneous indicator, are $8.2 million below the expected amount for the first quarter of this fiscal year. Slightly lower than expected refund payouts contributed $0.7 million to offset the first quarter's withholding weakness.

The corporate income tax had its third straight month of higher-than-expected revenue in September, coming in $1.6 million above the predicted amount for the month. This brings the year-to-date excess to $5.4 million, making the corporate income tax the sole revenue category that is materially ahead of expectations for the fiscal year to date. While it is nice to be 16% ahead of where the corporate income tax is expected to be as of the end of the fiscal year's first quarter, this is a very volatile revenue source and anything can happen in the remaining nine months of the fiscal year.

Sales tax revenue experienced its second consecutive month of underperformance in September, and the shortfall for the month ($5.1 million) was significant. An expected year-over-year decline of 2.7% actually turned out to be a 7.4% drop. To put this into perspective, since FY 1968 there have only been four instances where September sales tax revenue fell from the prior year (-1.0% in FY 1986, -0.2% in FY 1987, -2.3% in FY 2004, and -3.4% in FY 2008). The fiscal year-to-date number looks a bit better, with an expected first fiscal quarter year-over-year decline of -4.3% actually coming in at -5.1%. Again, for perspective, there has only been one prior instance of Idaho's first fiscal quarter sales tax actually declining on a year-over-year basis—a 0.1% decline in FY 1981.

Product taxes were essentially on target in September, leaving the fiscal year-to-date result at dead even. Miscellaneous revenue was $1.3 million higher than expected for the month, and stands $0.3 million below the amount expected for the first quarter of FY 2009. September's big gains came from a combination of higher-than-expected interest earnings and insurance premium tax collections. Each was ahead by $0.6 million for the month.